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No. 84-486

IN THE

Supreme Court of the United States

October Term, 1984

SHEARSON/AMERICAN EXPRESS INC. and JASON ALBERTSON,

Petitioners,

v.

CHARLES E. NEELY and JO MARIE DiMAGGIO,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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I.

CONSTITUTIONAL PROVISIONS, STATUTES, AND RULES

The petitioners improperly include 15 U.S.C. § 77bb as a statute which this matter involves, for the reason that both compensatory and punitive damages were awarded by the jury on pendent state claims for breach of fiduciary duty and negligence and not under the Securities Exchange Act of 1934, so the stated reference has no applicability to this proceeding.

II.

STATEMENT OF THE CASE

A. *Procedural History.*

Petitioners set forth that the complaint alleged that any loss in the account would be limited to five (5%) percent of the original portfolio.

The complaint is devoid of any such statement.

B. *Statement of Facts.*

Plaintiffs Charles Neely and Jo Marie DiMaggio are husband and wife. Ms. DiMaggio is 39 years old and has been blind since age 2-½ years. She has a Bachelor's Degree in Psychology and a Master's Degree in Counseling and Education. She was employed by the National Aeronautics and Space Administration in personnel and equal opportunity for ten (10) years, and is not presently employed. Charles Neely was a seminarian for six (6) years, receiving a Master's Degree in Religious Education, and was then a teacher of religion for 11-½ years, and for the last 1-½ years prior to opening the account at Shearson was a representative of National Write Your Congressman, a political action organization. He had no business experience and never bought or sold securities prior to the Shearson account. Jason Albertson, the broker employed by Shearson, acknowledged that Neely had no knowledge of stocks when he first met him prior to the opening of the account. Jo Marie DiMaggio had purchased 30 shares each in Bell, Heckinger, and Marriott some years before with a small investment and just retained the share certificates without trading further or maintaining an account at a brokerage house. Albertson acknowledged that she had limited knowledge of stocks and was not a sophisticated investor.

Her father died in 1975 and in July 1977 a portfolio of stock was transferred to her from his estate. When she received the stock she placed it in a safe deposit box and received dividends. The stock was worth about $30,000.00 when received and about $65,000.00 in early 1981. The plaintiffs checked the value of the stock as best they could about once a year, but Neely couldn't always understand the abbreviations in the newspaper stock listings.

In early 1981 the plaintiffs had a $10,000.00 certificate of deposit that was about to mature and had heard from relatives about money market funds at brokerage houses and decided that they would then inquire about placing those funds in a money market account and have the stock portfolio professionally managed.

It was at that time that they went to Shearson to see a broker by the name of Alicia Dickenson, who they found was not then employed there any longer, and they met Jason Albertson for the first time. That was in February, 1981. The office of Shearson was in Lancaster, California, under the jurisdiction of Joseph Moure, manager of the Pasadena office. It was manned only by Albertson and a secretary.

At that first meeting the plaintiffs told Albertson that they had the $10,000.00 certificate of deposit and that they had a portfolio of stock almost all of which Jo Marie DiMaggio had inherited from her father, giving him the names and number of shares. They discussed various types of investments, including annuities, utilities, the money market account, and Albertson displayed on his computer terminal various stocks that would yield more than the three (3%) percent that they were earning. He gave them a prospectus for the money market fund (SDDI) and the meeting con-

cluded with the plaintiffs to review the material and return at a later date. They had told Albertson that they were interested in the money market account and wanted to have their portfolio professionally managed because it had increased substantially in value, they had no retirement plan and did want to protect what they had and that this was their "nest egg."

The next meeting took place on March 2, 1981. Plaintiffs then brought with them the certificates for the three (3) small issues (Bell, Heckinger, and Marriott) to have Mr. Albertson sell those for them. When they presented those certificates Mr. Albertson became upset and stated that he couldn't manage such a small account, at which time Albertson left the office, returning a short time thereafter to reassure plaintiffs that he understood Jo Marie DiMaggio's emotional attachment to the major portfolio by reason of its inheritance from her father and that he understood why she had not brought it in that day.

At that meeting Albertson then went on to tell them that he was a conservative broker, in fact his clients thought "too conservative", that he was not going "to churn their stocks like a drunken sailor", that he wasn't going to let them "take a bath", explaining in response to plaintiff's query that a "bath" would be less than five (5%) percent.

Albertson raised the issue of a discretionary account and told the plaintiffs that he wanted that so that he could go "back and forth" between the funds in the money market fund and stock, and that it would be used only in an emergency to protect them from some catastrophe and that he would otherwise telephone them before making a trade.

Albertson discussed options with plaintiffs although he

did not give them the options prospectus. He explained that the sale of options on stock they owned was "risk free" and that they couldn't lose on option sales. He told them that option purchases were speculative and risky.

When the question of risk came up at a time when Albertson was completing certain account forms he equated risk with the Boeing and General Dynamics stock in their original portfolio.

Albertson did not discuss a margin account with the plaintiffs.

At the March 2nd meeting Albertson completed a new account form on which he listed plaintiffs' investment objectives as being: Appreciation/Risk; Appreciation/Safety; Income/Safety. Not checked on that form were: Income/Risk; Speculative.

The next meeting of the parties took place on March 25, 1981. By this time Albertson, pursuant to plaintiffs' instructions, had sold the Bell, Heckinger, and Marriott stocks for a total of $2,076.00 which was credited to their account. Plaintiffs delivered to Albertson their handwritten letter of instructions with regard to their account. That letter expressed plaintiffs' understanding with Albertson resulting from the March 2nd meeting. It provided: (1) Account to be joint; (2) Limited discretion given to defendants; (3) Monthly statements to be furnished; (4) $10,000.00 to be added to their SDDI account on March 25th for a total of $12,000.00; (5) By April 20, 1981 $8,000.00 was to be added to the SDDI account to be taken from stock proceeds, for a total of $20,000.00; (6) Needed $400.00 per month in income from stock dividends; and (7) Remainder of stock to accumulate for growth.

Plaintiffs delivered their stock portfolio to defendants at that time, it then consisting of: 200 Amicor, 450 Boeing, 200 EG&G, 500 General Dynamics, 100 General Electric, 100 Global Marine, 303 Occidental Petroleum, all of which had a value on March 25th of approximately $63,213.00.

The total of stock and cash delivered into the account by plaintiffs was $75,289.00, consisting of Bell, Heckinger, and Marriott proceeds of $2,076.00, $10,000.00 cash and the above portfolio of $63,213.00.

Albertson was to "lighten" up their holdings in Boeing and General Dynamics and while the other issues might be sold if Albertson felt it appropriate for their objectives, he would first advise them of any proposed trade. Albertson liquidated the entire account substantially on March 25th and 26th and entirely within sixty (60) days. Notwithstanding that Jo Marie DiMaggio was available on the telephone all day every day and Charles Neely every day until about 9:00 a.m., Albertson never telephoned them or made any contact as to any trade. He did not tell them of the possible tax consequences (capital gains) of the sale of their portfolio which had a low basis and was held for a long term. Albertson was then told that they would be moving to Arizona and that they would shortly need $10,000.00 from the SDDI fund to purchase a new home, intending to leave a balance of $10,000.00 in the SDDI. Albertson told plaintiffs that there would be no problem earning $800.00 per month so that there was no question about producing $400.00 monthly, which they required.

Plaintiffs signed and delivered Shearson's Customer Agreement form on April 22, 1981.

Subsequent to the March 25th meeting immediately after liquidating a substantial portion of their original portfolio,

Albertson purchased stock and sold options for plaintiffs' account.

During the period of time that defendants managed the account there was a net loss in the account of $21,959.14. Plaintiffs had withdrawn $10,000.00 to purchase a home in Arizona, $6,000.00 to purchase special equipment for the blind for Jo Marie DiMaggio, and $3,000.00 for living expenses, thus reducing the original account from $75,289.00 to $56,289.00. They were charged $1,326.00 in interest on their margin account and paid defendants approximately $5,050.00 in commission. The sum of $3,000.00 which they withdrew came from their margin account, not from the sale of stock or cash in the SDDI account.

When plaintiffs received the April 30, 1981 statement Jo Marie telephoned Albertson because she didn't recognize the names of the stocks purchased. He assured her that they were all proper and satisfied her inquiry. Charles Neely then called Albertson because he didn't understand the monthly statement and was confused by the terms "priced portfolio value" (which showed $80,533.00) and "equity" (which showed $59,103.00). Albertson assured him that the higher figure was the important one and that everything was all right in the account. In that same statement the notation "$21,429.03 DR" appeared and plaintiffs did not understand that it meant they owed Shearson that sum on margin. (They didn't know they had a margin account, and didn't want one.) The notation "Market Maker" appeared in relation to certain of the transactions and they didn't know what it meant or that it had any significance, and Albertson never explained it to them. The word "call" appeared and they didn't know and weren't told that it referred to options.

Late in November, 1981 plaintiffs were told by a lecturer at a real estate seminar that it looked as if their stock portfolio was worth less than they believed it to be. At that time Charles Neely called Moure, Shearson's manager, and when Neely asked whether the apparent loss resulted from mismanagement Moure responded: "Well, I wouldn't go that far." Up until this time plaintiffs had confidence in Albertson and believed that he had been managing their account in accordance with their original discussions.

Albertson admitted that he did not comply with various of Shearson's internal regulations in the handling of plaintiffs' account, options were difficult to explain and that the prospectus was "difficult reading", that he traded in their account prior to April 22nd when he received the signed Customer Agreement form, various stocks that he bought for plaintiffs were "speculative" or a "gamble", that he had only two (2) or three (3) other discretionary authorizations in his twenty (20) year career. He testified that his personal portfolio, which included some of the same stock as plaintiffs and also commodities, was very speculative and that the conservative portion of his portfolio was real estate.

Joseph Moure, Shearson's manager, admitted that discretion is not used in 99.9% of the trades in the market, is not usually used for retail clients, is not encouraged by him, Shearson, or the industry; that the discretion was not effective until April 13th; that discretion was used in the Market Maker trades, which was contrary to Shearson's regulations and case decision; that he failed to comply with Shearson's regulation on account management; that Shearson's termination notice to the NYSE regarding Albertson related to a matter in addition to plaintiffs as to the reference therein that Albertson had committed unethical and improper acts.

Plaintiffs' experts testified as follows:

1. William Pluchel, Associate Vice-President at Dean Witter Reynolds at Phoenix, Arizona. Plaintiffs' primary objectives were income and liquidity. Long-term growth investments were not appropriate because they were moving to Arizona shortly after March 25, 1981, buying a new home, Charles Neely was entering a new profession (real estate sales). Their proper investment vehicle was utility stocks yielding 11%-12%, and a money market fund then paying 15%-16%. He testified that the goals checked off by Albertson were totally wrong, that discretion was in no way called for and a very unusual device. The facts upon which Albertson exercised the time/date (oral) discretion were insufficient in that there must be a specific order for a specific number of shares in a named stock which did not exist in this case. None of the stocks (except "possibly Amerada Hess") purchased in the Neely account by Albertson were suitable for them. A margin account was not at all appropriate, options should have been used to dispose of their long-held stock, none of the stocks purchased would have satisfied plaintiffs' income goal, merely because Albertson received Shearson's periodic recommended stock lists doesn't mean that those stocks were appropriate for plaintiffs because various investors have different objectives and while good for one investor they are not necessarily good for all, and speculative stocks were certainly not appropriate.

2. Eugene Tompane, in the securities business since 1928, formerly an allied member of the New York Stock Exchange, presently an investment advisor. Plaintiffs should have obtained short-term obligations, government bonds, investment and interest-bearing securities. Their investment objective was "very conservative." The few stocks purchased

in their account which might have been appropriate for long-term growth were rendered inappropriate by their sale within five (5) months. The American Cyanamid option was highly speculative and not proper. Discretion was not justified, nor was trading on margin. The rate of turnover was 3.03, which was excessive for the plaintiffs in relation to their investment objectives. That rate would be appropriate for a speculative account. For Albertson to have used discretion to purchase and sell stocks in which Shearson made a market was a definite conflict of interest. The claimed price/date discretion procedure used by Albertson was contrary to NYSE practice.

III.

ARGUMENT

A. Compensatory damages were awarded in an appropriate amount, consistent with the evidence and the agreed instructions to the jury.

Petitioners claim in Point V(A) that reversible error was committed in the trial court in that defendants were deprived of the opportunity of showing the change in market value during the critical period, and the effect thereof upon the award for compensatory damages.

The trial court, in its ruling on plaintiffs' Motion In Limine, ordered that defendants not introduce evidence as to what the course of plaintiffs' portfolio value would have been had they retained that portfolio in its original state and had no trading been conducted during the period in question.

As was pointed out by the trial court and by the Court of Appeals, the complaint of the plaintiffs was mismanagement by defendants and the resulting damage from that breach of fiduciary duty. The measure of damages was the actual loss

in portfolio value. Jury Instruction No. 67 (set forth in the Appendix hereto attached) was given by the court as an agreed instruction and, in defendants' Motion for a New Trial, they stated with regard thereto:

> 4. Instruction No. 67 related to breach of fiduciary duty and negligence theory. This permitted a maximum compensatory award of $21,959 representing plaintiffs' version of the entire loss in the account.
>
> It seems clear that the jurors chose Instruction No. 67 (breach of fiduciary duty-negligence) as the basis for their verdict since none of the other instructions would have permitted a compensatory award of $21,959.

That motion was denied by the trial court.

The Court of Appeals, in its opinion, in referring to the award of the jury and Instruction No. 67, stated:

> The jury's award of $21,959 is consistent with this instruction.

In addition to the foregoing, Jury Instruction No. 59 (a copy of which is hereto attached) set forth the generally accepted formula for determining damages in a Rule 10b-5 case as enunciated in *Rolf v. Blyth, Eastman Dillon & Co., Inc.*, 637 F.2d 77 (2d Cir. 1980). This was also an agreed instruction.

There is no conflict on this point and petitioners' position is not well taken.

B. The award of punitive damages was proper, and was consistent with the substantive law of the states of California and Arizona, which were the only states having contact with the parties and the subject matter; a ratio between compensatory and punitive damages is not applicable under the law of those states.

Petitioners next urge that the award of punitive damages is excessive in that it was (1) based upon an improper award of compensatory damages of $21,959.00 and (2) it was in excess of a three to one (3:1) ratio as expressed in *Miley v. Oppenheimer & Co., Inc.*, 637 F.2d 318 (5th Cir. 1981).

At the outset, it is to be pointed out that all parties stipulated that the law of the case would be governed by the State of California where the contract was made, and where plaintiffs resided when most of the trades took place.

The award of punitive damages was made only upon the pendent state claims for breach of fiduciary duty and negligence, the same not being a permissible element of damage in a Rule 10b-5 action.

In *Miley v. Oppenheimer* the court, at page 331, expressly applied the state law of Texas with regard to punitive damages. That state has a four (4) part test, one of which is the ratio between exemplary and actual damages. In arriving at a ratio the court found three to one (3:1) to be appropriate.

California, and for that matter Arizona where the case was tried, do not adhere to the application of a ratio. Both of those states hold that the determination of the jury is conclusive so long as there is no passion or prejudice found to exist which caused the jury to hold as it did. Here defendants do not claim, and have never claimed, the existence of passion or prejudice.

In *Wetherbee v. United Insurance Company of America,* 18 Cal. App. 3d 266, 95 Cal. Rptr. 678 (1971) where the appellate court sustained punitive damages of $200,000.00 with compensatory damages of $1,050.00. The court held at page 681:

> There is no fixed ratio by which to determine a proper proportion between the two classes of damages; the factors influencing the amount of the exemplary award can only be disclosed by the trial record.

To the same effect: *Weisenburg v. Molina,* 58 Cal. App. 3d 478, 129 Cal. Rptr. 813 (1976); *Walker v. Signal Companies, Inc.,* 84 Cal. App. 3d 982, 149 Cal. Rptr. 119 (1978); *Mihara v. Dean Witter & Co., Inc.,* 619 F.2d 814 (9th Cir. 1980); *Nienstadt v. Wetzel,* 133 Ariz. 348, 651 P.2d 876 (1982).

With regard to the issue of punitive damages we have no conflict whatever as regards the decisions between the various Circuits. Whatever inconsistency there may be is with the substantive law of the several states, which is applied by the federal courts as regards pendent state claims which may come before them.

Notwithstanding that all litigants may regard their matter as being of great consequence, when viewed objectively the instant case involves nothing of "special or important" concern which might warrant a review by this court.

IV.

CONCLUSION

For the reasons set forth above, respondents respectfully request that the Petition for Writ of Certiorari be denied.

Dated: October 18, 1984.

Respectfully submitted,

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JURY INSTRUCTION NO. 59

Compensatory Damages for Churning

If you find that the defendants mishandled the plaintiffs' account in violation of Rule 10b-5 of the Securities Act of 1934, then the plaintiffs are entitled to damages to compensate them for their losses.

The amount of their compensatory damages is arrived at by taking the value of the original portfolio, adjust that sum by the percentage in change in the appropriate index like the Dow Jones Industrial Average, New York Stock Exchange Index, between the date the account was opened and the date that it was closed, deduct the funds that the plaintiffs withdrew, and then deduct the value of the portfolio as of the date that the account was closed.

JURY INSTRUCTION NO. 67

Damages for Breach of Fiduciary Duty

If you find that the defendants breached their fiduciary duty owed to the plaintiffs, then you are to award plaintiffs damages equal to the loss in portfolio value, including any excessive commission, which resulted from that breach of duty.